Part 1 The Legal Environment of Business CHAPTER 6 Criminal Law and Business Page 112 CASE OPENER A Questionable Stock Investment For approximately 20 months, Robert E. McDonald perpetrated a scheme to solicit millions of dollars, purportedly for a $100 million purchase by the RAI Entities and certain other related corporate entities, of approximately 14 Marriott and Hilton branded hotels. He made false representations that the RAI Entities and/or related entities had already raised substantial capital assets toward the purchase of the Midwest Hotel Portfolio, that the RAI Entities and/or Related Entities had tens of millions of dollars on deposit at various financial institutions, including J.P. Morgan and Citibank, and that investor funds would be put toward the purchase of the Midwest Hotel Portfolio. The defendant knew that these representations were false. The defendant created phony bank statements that he provided to the hotel investor and failed to inform the hotel investor that he had been previously convicted for fraud offenses and was currently under federal supervised release. After having obtained approximately $1,486,323 from a hotel investor and sending the investor stock certificates by Federal Express from New York, New York, the defendant caused the hotel investor's funds to be diverted to the defendant's own use, including through an interstate wire transfer of approximately $145,000 on or about January 15, 2010, to a Citibank account the defendant maintained in New York, New York. Which crimes do you believe that McDonald committed? Does it matter that the stock certificates were sent via Federal Express rather than the U.S. Mail? LEARNING OBJECTIVES LO 6-1 Explain the basic elements of a crime. LO 6-2 Explain how are crimes classified. LO 6-3 Recognize who can be held responsible when a corporate crime is committed. LO 6-4 Outline the basic steps of a criminal proceeding. LO 6-5 Describe the laws that attempt to prevent white-collar crime. Page 113 Crime comes in many forms, and sometimes the number of people affected can quickly grow. Although some crimes might at first seem victimless, there is always a victim, and especially with white-collar crimes, there are often many victims. Imagine, for example, if McDonald had not just offered his "investment opportunity" to one person, but to several. In many crimes involving securities, the perpetrator lures not just one victim into his fraudulent scheme, but many. This chapter helps the future business manager recognize when conduct has become criminal. The discussion begins by introducing the elements of a crime and explaining some common crimes that occur in the business context. After discussing how liability can be imposed on corporations and corporate executives, the chapter sets forth the steps of criminal procedure. The chapter concludes by discussing some of the laws used to fight business crime.

The Nature and Elements of a Crime LO 6-1 Explain the basic elements of a crime. The purpose of criminal law is to punish an offender for causing harm to public health, safety,

or morals. In a criminal proceeding, the government files the charges against the defendant. Thus, the government is always a party to a criminal action. Government involvement distinguishes criminal trials from civil proceedings. As you may recall from Chapter 3, an individual person or corporation can file a civil lawsuit. This difference exists because in a criminal trial, society is seen as the victim, whereas a civil trial involves an individual victim or victims. In many situations, a particular course of conduct may lead a defendant to be prosecuted for committing a crime and to be sued in civil court for compensation by the victims of the crime. The outcome of the two cases may not be the same, however, for a number of reasons. As you will learn, the precise elements needed to prove the resulting criminal and civil cases will be different, and whereas many of the steps of civil and criminal procedure are the same, the defendant has additional protections in the criminal case. For example, the burden of proof in the criminal case is beyond a reasonable doubt, which is a much higher standard than that of a civil case, which, as you learned in Chapter 3, is a preponderance of the evidence. You will learn about many of the additional protections afforded criminal defendants later in this chapter. Elements of a Crime Criminal laws usually define criminal behavior and set guidelines for punishment. To punish an individual for criminal behavior, the government must demonstrate the two elements of a crime: Wrongful behavior, that is, actus reus (guilty act). Wrongful state of mind, also known as mens rea (guilty mind). The government thus must show that a defendant committed a prohibited act with a wrongful intent. To prove the first element, actus reus (guilty act), the government must establish the nonmental elements of the crime. That is, the government must demonstrate that a prohibited act or a prohibited consequence resulted because of the behavior of the defendant. To prove the second element, mens rea (guilty state of mind), the government must prove that the defendant acted with the state of mind required by the law defining the relevant offense. The state of mind required by an offense may be purposeful, knowing, reckless, or negligent. The defendant's type of wrongful state of mind helps determine the seriousness of the punishment for the crime. A defendant can purposefully commit a crime by engaging in a specific wrongful behavior to bring about a specific wrongful result. For example, a person who robs a bank at gunpoint to unlawfully gain money is acting purposely. A defendant can knowingly commit a wrongful act if the person knows the act is wrongful or believes that the act is wrongful yet does nothing to confirm or disconfirm this belief. The distinction between purposely and knowingly committing a crime can be subtle, but still distinct. For example, say a person wants to murder an enemy by blowing up the office building in which his enemy works. The perpetrator is aware that this act will likely kill other people in the building but does not care. The perpetrator would be purposely murdering his enemy but knowingly murdering the other people in the building. Page 114 A defendant is reckless if a criminal act occurs when the individual consciously ignores substantial risk. Drinking and

driving is a common example of a reckless crime. Driving while under the influence of alcohol carries significant and apparent risks for the driver and others; choosing to do despite those risks is acting recklessly. Finally, a defendant is negligent if he or she does not meet a standard of care that the reasonable person would use in the context that led to the criminal act. For example, a parent leaving his children in a hot car while the parent is having a good time at a bar would acting criminally negligent. In certain cases, liability may be assessed even without establishing the guilty-mind criterion just mentioned. Only certain crimes, typically violations of regulatory statutes, allow punishment to be assessed without having to prove a guilty mind. When liability is assessed without the guilty-mind criterion, it is known as liability without fault or strict liability. Liability without fault involves actions that, regardless of the care taken, are deemed illegal to engage in; such acts are specifically prohibited regardless of state of mind. Liability without fault would apply, for example, if a business were to sell cigarettes or alcohol to a minor. Although the business might not have intended to sell cigarettes or alcohol to a minor (thus lacking a guilty mind), the statutory violation still allows liability to be imposed. Classification of Crimes LO 6-2 Explain how crimes are classified. Crimes are divided into categories based on the seriousness of the offense. Today, the categories used are felonies, misdemeanors, and petty crimes. Felonies include serious crimes, such as murder, that are punishable by imprisonment for more than one year in a penitentiary or by death. Misdemeanors are less serious crimes punishable by fines and/or imprisonment for less than one year. Petty offenses, such as violating a building code, are minor misdemeanors and are usually punishable by a jail sentence of less than six months or a small fine. The statute defining the crime usually establishes whether the crime is a felony, misdemeanor, or petty offense. Crimes may also be federal or state, depending on whether they are created by the state or federal legislature.

White-Collar Crime Originally, white-collar crimes were distinguished from other crimes because of the social status of the offender. The more modern approach is to define white-collar crime as a variety of nonviolent illegal acts against society that occur most frequently in the business context. Clearly, the crimes described in the Case Opener fall under this broad definition of white-collar crime. Mail fraud, bribery, embezzlement, and computer crimes are examples of offenses typically classified as white-collar crimes. These crimes occur more frequently than you might think. According to some estimates, one in three American households is the victim of white-collar crime every year. The consequences of white-collar crimes are far-reaching. First, the cost of white-collar crimes can be tremendous. According to some estimates, fraud in the health care industry alone costs society over $100 billion each year. Second, when company employees commit the

crime, many companies fail to report the crime to avoid publicity. Third, white-collar crimes can be costly to the environment. For example, improper disposal of chemicals, such as dumping chemicals in a stream, has long-term repercussions for marine life, the surrounding ecosystem, and any humans who may come in contact with the contaminated water source. Of course, the amount of money collected in fines from corporate executives engaged in criminal activity has not been insignificant either. For example, in 2010, the federal government collected $2.8 billion in restitution, criminal fines, and felony assessments in criminal cases.1 Fines, however, are only one way that those found guilty of fraud and other white-collar crimes might be punished. Page 115 There are at least four other ways to punish white-collar criminals. First, incarceration has been mandated for certain types of white-collar crimes. As the prevalence of white-collar crime has increased, so too has the number of white-collar offenders who are in jail. Second, white-collar criminals may be ordered to do community service, such as giving speeches about business crime. For instance, junk-bond king Michael Milliken was compelled to give speeches about corporate crime after he was convicted of insider trading. Third, judges may disqualify the individual from employment. For instance, the judge may prohibit the offender from engaging in an occupation in which the same or a similar criminal act could occur again. Fourth, the offender can be placed under house arrest. Individuals must wear a sensor so that the government can monitor whether they have left their houses. With changes in technology, and governments that are increasingly pressed financially, governments are increasingly looking for sentences other than imprisonment for nonviolent offenders. People in the criminal justice field are also starting to recognize that there is something wrong with a system that results in a higher incarceration rate in the United States than in other industrialized nations. According to the most recent statistics, the United States was incarcerating 770 persons per 100,000, whereas the rate in Europe was around 110 per 100,000. Specific White-Collar Crimes Bribery One of the better-known white-collar crimes is bribery. Bribery is the offering, giving, soliciting, or receiving of money or any object of value for the purpose of influencing the judgment or conduct of a person in a position of trust. Bribery of a public official is a statutory offense under federal law. The purpose of this law against bribery is to maintain the integrity of the government. This statute also covers bribes offered to witnesses in exchange for testimony. Perhaps one of the most publicized examples of bribery was the 2002 Winter Olympics bribery scandal in Salt Lake City, Utah. The Salt Lake City Olympics Bid Committee allegedly gave International Olympic Committee members between $4 million and $7 million in cash and other benefits. These benefits included college tuition assistance payments, shopping trips for bathroom fixtures and doorknobs, and trips to the Super Bowl. More common, however, is the simple cash bribe to obtain a government contract. For example, in 2008, the CEO of a multimedia communications company was convicted of paying over $200,000 in bribes

to the technology director of Atlanta Public Schools to secure contracts to help connect schools in poor and rural areas to the Internet. He was sentenced to a five-year prison term and payment of restitution. The government official who had accepted the bribe, and ultimately testified against the man who bribed him, was sentenced to three years in prison.2 To demonstrate bribery under this statute, the government must show three elements: (1) something of value was offered, given, or promised to; (2) a federal public official with; (3) intent to influence that person's judgment or conduct. The "thing of value" element has been construed very liberally; actual commercial value is not necessary. For instance, had the Salt Lake City Olympics Bid Committee given a member of the International Olympic Committee shares of stock in a new Silicon Valley start-up called BellyUp.com but the shares turned out to be worthless because the start-up was never established, this act may constitute bribery even though the stock is commercially worthless. Ultimately, the Department of Justice was unable to prove any of the 15 charges of bribery that it had filed against two members of the Salt Lake City Olympics Bid Committee. Several members of the committee resigned, however. As a result of investigations into the matter, 10 members of the International Olympics Committee were fired and another 10 were sanctioned. Additionally, the definition of "public official" is also expansive. The statute defines public officials as members of Congress, government officers and employees, and anyone "acting for or on behalf of" the federal government "in any official function, under or by authority of" a federal government department or agency. For example, individuals who work for private corporations that have some degree of responsibility for carrying out federal programs or policies are considered public officials. Page 116 Another type of bribery is commercial bribery, which includes a bribe in exchange for new information or payoffs. For example, suppose Comdac Computers is looking for a company that manufactures a certain type of computer part. Jane Devlon owns such a company and realizes that if Comdac gets the computer parts from her, she will potentially make a lot of money. When Comdac sends its contractor to the Devlon factory, Devlon offers the contractor $500,000 in exchange for the contractor's promise that Comdac will buy all such parts from only her factory for the next year. Alternatively, she might offer the contractor $5,000 to disclose the dollar amounts of the competing bids so that she can offer a better bid to earn the contract. One final type of bribery is the bribery of foreign officials. The purpose of the Foreign Corrupt Practices Act (FCPA) is to combat such bribery. The FCPA prohibits payments to foreign officials to influence an official act or decision corruptly or to influence a foreign government. You might think of the FCPA as an extension of the law to prevent bribery of a public official. The FCPA allows the government to prosecute those who bribe foreign officials. But Congress does not pass laws affecting foreign affairs in a vacuum. Laws governing white-collar crime, like all laws, are dynamic, and one source of change in these laws is international law. Multinational organizations in

which the United States is a member often pressure the United States to alter American law so that it conforms to certain international standards. Thus, for example, Congress amended the FCPA in 1998 to conform to the antibribery convention adopted by the Organization for Economic Cooperation and Development (OECD). The amendments broaden the scope of actions the FCPA covers and the definition of a public official. As of this writing, 30 OECD countries—such as Japan, South Korea, and Brazil—are expected to adopt similar antibribery statutes. Extortion Often confused with bribery, but completely different, is the crime of extortion. Extortion, otherwise known as blackmail, is the making of threats for the purpose of obtaining money or property. Whereas bribery is offering someone something to obtain a desired result, extortion involves the threat of doing something if the target of the extortion does not relinquish money or a specific piece of property. Fraud Criminal fraud encompasses a variety of means by which an individual intentionally uses some sort of misrepresentation to gain an advantage over another person. Fraud generally requires the following three elements: (1) a material false representation made with intent to deceive (scienter), (2) a victim's reasonable reliance on the false representation, and (3) damages. Both the federal and the state governments have passed a number of statutes codifying specific types of fraudulent schemes. These schemes to defraud include a multitude of frauds, such as credit card fraud, insurance fraud, and securities fraud. Exhibit 6-1 summarizes the fraudulent acts that might occur in the corporate setting, many of which are discussed in this chapter. Exhibit 6-1Selected Fraudulent Crimes Forgery: The fraudulent making or altering of any writing in a way that changes the legal rights and liabilities of another. Defalcation: The misappropriation of trust funds or money held in a fiduciary capacity. False entries: The making of an entry into the books of a bank or corporation that is designed to represent the existence of funds that do not exist. False token: A false document or sign of existence used to perpetrate a fraud, such as making counterfeit money. False pretense: A designed misrepresentation of existing facts or conditions by which a person obtains another's money or goods, such as the writing of a worthless check. Fraudulent concealment: The suppression of a material fact that a person is legally bound to disclose. Mail fraud: The use of mails to defraud the public. Health care fraud: Any fraudulent act committed in the provision of health care products or services. Telemarketing fraud: Any scheme, including cramming and slamming, using the telephone to commit a fraudulent act. Ponzi scheme: An investment swindle in which high profits are promised from fictitious sources and early investors are paid off with funds raised from later ones. Check kiting: Drawing checks on an account in one bank and depositing them in an account in a second bank when neither account has sufficient funds to cover the amounts drawn. Just before the checks are returned for payment to the first bank, the kiter covers them by depositing checks drawn on the account in the second bank. Due to the delay created by the collection of funds by one bank from

the other, known as the float time, an artificial balance is created. Pretexting: Using fraudulent means to obtain information about someone's phone use. One of the FBI's largest securities fraud crackdowns occurred in June 2000, when it arrested a group of mafia leaders for a series of scams that cost investors an estimated $25 million. Government officials claimed that the mob bought large stakes in small companies and then bribed and coerced brokers to promote the stocks to other investors at inflated prices. The Enron scandal also involved securities fraud, with Enron's top executives allegedly overstating its earnings to maintain high stock prices. Complex accounting methods were used to hide the corporation's debt. Enron's top executives and big investors sold their stocks while encouraging employees to continue buying company stocks. With the drastic decline in the company's stock value, many Enron employees lost much of their 401(k) investments. Another specific type of securities fraud in the Enron case is insider trading. Insider trading is generally the buying or selling of a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, nonpublic information about the security. Enron's big investors and top executives knew the stock prices were inflated due to overstated earnings. They used this information, which was not public knowledge, to sell off their stock before the price fell. Page 117 In March 2011, another apparent insider-trading scheme came to light when it was alleged that a corporate lawyer and a trader operated an insider-trading scheme that lasted decades and earned the two $32 million. The lawyer worked for a mergers and acquisitions firm, and he gave nonpublic information about deals the firm was working on to his partner, the trader, so that he could make appropriate stock trades using this information. One of their alleged profitable inside trades occurred when information that the lawyer acquired in April 2009 about Oracle's proposed bid for Sun Microsystems led the trader to purchase more than 4 million shares of the target company, which he was then able to make a handsome profit on when the deal closed in 2010.3 Insider-trading violations may also include "tipping" such information and trading on it by the person "tipped."4 A tippee who receives such information with the knowledge that its disclosure breached the tipper's duty acquires that duty and may be liable for securities fraud for any undisclosed trading on the information. Thus, if a person has inside information and does not trade on it himself but passes it on to another who uses it to trade, the person who passed on the information is guilty of insider trading. Tippee liability requires that the tipper's disclosure breaches a fiduciary duty, which occurs when the tipper discloses the information for a personal benefit. A personal benefit may be inferred where the tipper receives something of value in exchange for the tip or makes a gift of confidential information to a trading relative or friend. The following case illustrates how the U.S. Supreme Court recently clarified how to establish a tippee's liability. Page 118 Stock-option backdating is yet another type of securities fraud that the SEC has been increasingly cracking down on. Backdating occurs when an employee

falsifies documents to make it appear as though the company had granted options on certain dates, but the dates are selected after the fact by looking backward for dates on which the stock price was low, thereby falsely inflating the net profits of the company. In 2007, Myron F. Olesnyckyj, the former general counsel of Monster Worldwide, Inc., pleaded guilty to securities fraud for participating in a multiyear scheme with other Monster executives to secretly backdate stock options granted to thousands of Monster officers, directors, and employees, including himself. By backdating and improperly accounting for options, Monster granted undisclosed compensation to its employees, failed to recognize compensation expenses, and overstated its net income by $340 million from 1997 through 2005. Olesnyckyj personally made $381,000 from the scheme, which he agreed to forfeit. Page 119 An additional type of fraud is false pretense. False pretense is the illegal obtaining of property belonging to another through materially false representation of an existing fact, with knowledge of the falsity of the representation and with the intent to defraud. For example, Jim goes door-to-door selling vacuum cleaners at an amazing discount. To obtain the discount, the customers must pay immediately, and the vacuum cleaner will be delivered in three to five business days. However, Jim possesses no vacuum cleaners and does not plan to deliver any. Jim has committed the crime of false pretense because he illegally obtained another's property (the money he received as payment) by making a false representation (telling the customers they would be receiving a vacuum) with the knowledge of the falsity (he knew there were no vacuum cleaners) and the intent to defraud (he did not plan to deliver any vacuum cleaners). Forgery, the fraudulent making or altering of any writing in a way that changes the legal rights and liabilities of another, is another type of fraud. If you sign your colleague's name to the back of a check made out to your colleague, you have committed forgery. One of the most frequently prosecuted frauds is mail fraud, which is the use of mails to defraud the public. The Mail Fraud Act of 1990 makes mail fraud a federal crime. To prove mail fraud, the government must demonstrate two elements: (1) an intent to defraud and (2) the use of or causing the use of mails to further the fraudulent scheme. Case 6-1 demonstrates how the courts address the second element. CASE 6-1 SALMAN v. UNITED STATES United States Supreme Court 137 S. Ct. 420 (2016) FACTS: Petitioner Salman was indicted for federal securities-fraud crimes for trading on inside information he received from a friend and relative-by-marriage, Michael Kara, who, in turn, had received the information from his brother, Maher Kara, a former investment banker at Citigroup. Maher testified at Salman's trial that he had shared inside information with his brother Michael to benefit him and expected him to trade on it. Michael testified to sharing that information with Salman, who knew that it was from Maher. Salman was convicted. ISSUE: If an insider just gives inside information to an outsider without receiving a financial payment for that information, can the insider still be held liable for insider trading? REASONING: The Securities Exchange Act of 1934 as well as

SEC Rule 10b-5 prohibit undisclosed trading on inside corporate information. It is also prohibited for someone with insider information to give, or tip, that information to others for trading. The receiver of insider information, or tippee, acquires the tipper's duty to disclose the inside information or abstain from trading on it. In Dirks v. SEC, the Supreme Court ruled that the tippee's responsibility derives from the fact that the tipper breached a fiduciary duty when disclosing the information for personal benefit. This personal benefit can even include when the tipper is giving the confidential information as a gift to a relative or friend. In this case, Salman argued that giving a gift of information to a relative does not constitute securities fraud. Salman contended that a tipper does not personally benefit unless he or she gains something of tangible value in exchange for the information. However, the Supreme Court ruled that Dirks is quite clear that when a tipper gives inside information to a trading relative or friend, a jury can infer that it is equivalent to a cash gift (the assumption being that the trades made on the information will make money in the future). In these cases, the tipper benefits personally in the same way that giving someone a tangible money gift benefits personally. When Maher tipped the information to Salman, Maher breached a duty of trust to Citigroup and its clients—a duty which Salman inherited and breached himself by trading on the information. DECISION AND REMEDY: Yes, he can. And therefore Salman's conviction for insider trading was affirmed. SIGNIFICANCE OF THE CASE: This case illustrates that tipping and/or trading based on insider information—regardless of the type of information, who tipped it, and the reasons for tipping—is invariably illegal; there really is not any way around insider trading restrictions. CRITICAL THINKING How would you evaluate the court's claim that giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds? ETHICAL DECISION MAKING Which stakeholders benefit the most from the decision in this case? CASE 6-2 UNITED STATES v. VEGA-MARTÍNEZ United States Court of Appeals for the First Circuit 949 F.3d 43 (2020) FACTS: In 2013, Vega-Martínez, Garay-Rodríguez, and their codefendants owned competing bus companies that sought to provide busing for low-income students from Caguas to public schools in the area. That year, the municipality announced that it would hold an auction for four-year school-bus-transportation contracts. Instead of independently submitting competing bids, the conspirators met and agreed to divide up the routes among themselves. For each route, a "winner" was predesignated, and that "winner" was assured that, at most, only one other bidder would bid on the route (to make it look like there was competition), and that bid would be a high bid. After the meeting, bids were submitted. The municipality rejected all of the high bids and instead negotiated contracts with each of the low bidders without realizing what had happened. The municipality then sent award letters to the successful defendants in the mail. Over a year later, news of the bid rigging leaked. One of the bus-company owners had taped the meeting at which the scheme was put together. In May 2015, the defendants were charged

in an indictment alleging conspiracy to restrain trade, conspiracy to commit mail fraud, and substantive mail fraud. All defendants were convicted on all charges, and were each sentenced to a prison term of one year and one day, plus a year of supervised release. Following trial, conviction, and sentencing on charges of mail fraud and violations of the Sherman Act, Luciano Vega-Martínez and René Garay-Rodríguez appealed, raising a variety of issues, including a claim that there was not enough evidence to convict the defendant of mail fraud. ISSUE: What kind of evidence would be sufficient to convict the defendants of mail fraud? REASONING: Here the government presented evidence to establish both elements of a mail fraud conviction: that the defendant (1) devised or intend[ed] to devise a scheme to defraud and (2) use of the mail for the purpose of executing or attempting to execute a fraudulent scheme. The government presented clear evidence of a scheme to defraud through the testimony of Aldea-Rodríguez and documentary evidence of the bids, including the defendants' certifications that their bids were “fair and free of collusion or fraud,” a statement that the jury obviously decided was false. The government then showed that the scheme required a relevant and foreseeable use of the mail because the defendants received the object of the conspiracy—their contract award letters—by certified mail. Proof of mail fraud does not require proof of an actual mailing by the specific defendant, only that the defendants caused the use of the mail, which includes reasonably foreseeable mailings and mail used for the purpose, or in furtherance, of executing the scheme to defraud. Aldea-Rodríguez's testimony and tape recording of the meeting at which the conspiracy was hatched, as well as documentation of the defendants' phone calls and bid submissions, sufficiently supported a finding that the defendants agreed to submit fraudulent bids and cause the municipality to send out award letters based on that fraudulent information, which proves a conspiracy to commit mail fraud. SIGNIFICANCE OF THIS CASE: This case provides an example of how the government establishes mail fraud and also shows that the defendants do not actually have to use the mail themselves as long as they cause the use of the mail in furtherance of their fraudulent scheme. In other words, the victim of the scheme may actually be the one who uses the mail. CRITICAL THINKING Can you think of any alternative interpretation of the mail fraud statute that, had it been adopted, could have prevented the defendants conviction from being upheld? ETHICAL DECISION MAKING Had he considered the public disclosure test before joining in the conspiracy, how might the defendant have acted in this case? Explain what his reasoning would have been in taking an alternative course of action. Page 120 Congress amended the mail fraud statute in 1994 to include commercial carriers and courier services as substitutes for the U.S. mail. Thus, using FedEx or UPS to further a fraudulent scheme can be prosecuted as mail fraud. Similarly, the wire fraud statute attempts to prevent the use of wire, radio, or television transmissions to defraud the public. Other types of fraud include health care fraud, telemarketing fraud, and bankruptcy fraud. The

Department of Justice recently named health care fraud its top priority after violent crime. An example of health care fraud is the submission of false claims to insurance plans such as Medicare or Medicaid. Additionally, some doctors prescribe unneeded equipment to patients and then receive kickbacks from the manufacturers of the equipment. Telemarketing fraud has also gained much attention. The National Fraud Information Center reported that telephone cramming was the top telemarketing fraud of 1998. Cramming is a scheme in which companies bill consumers for optional services that the consumers did not order. Another frequent telemarketing scheme is slamming, in which consumers are tricked into changing their phone service to another carrier without their consent. In 2014, the FTC settled a long running case against a group of defendants who engaged in text message, robocall, and cramming schemes involving offers for "free" merchandise, recovering approximately $10 million. The elderly, who have been more susceptible to telemarketing fraud, are often the specific targets of telemarketing schemes. Thus, the Department of Justice and the FBI have been collaborating on various undercover operations, such as Operation Senior Sentinel, to investigate and prosecute fraudulent telemarketers. Another type of fraud involves bankruptcies. In 2014, 1,107,699 bankruptcy claims were filed. An individual can file for bankruptcy to be relieved of oppressive debt. Yet claims need to be reviewed carefully to prevent bankruptcy fraud. For example, an individual might hide some assets so that these will not be considered during the proceedings. Or, as one of the stars of the Real Housewives of New Jersey show did, a person might hide part of her income. In the Real Housewives case, the housewife claimed to be unemployed, even though she had allegedly just signed a contract for a second season of Real Housewives, and she did not reveal her income from website sales and personal and magazine appearances. Conversely, a creditor (a party to whom another owes money) might file a false claim against a debtor (the party who owes money to a creditor). Thus, bankruptcy fraud can occur on the part of the debtor or the creditor, although 70 percent of bankruptcy fraud claims involve concealment of assets by the debtor. The U.S. Department of Justice estimates that 10 percent of all bankruptcy petitions contain some elements of fraud. Yet, according to a report by the U.S. Department of Justice, in fiscal year 2012, the United States Trustee Program (USTP) filed 2,120 criminal referrals, a 7.7 percent increase over the 1,968 criminal referrals made during fiscal year 2011. One way the Justice Department is attempting to fight bankruptcy fraud is through its Internet hotline, where the public can report suspected bankruptcy fraud to the USTP. Page 121 Bankruptcy fraud is punishable by a fine of up to $250,000 and/or up to five years in prison, but often the person who engages in bankruptcy fraud is also engaging in another crime, such as tax evasion, which can result in greater penalties. For example, in 2013, Larry Lake was sentenced to 168 months in prison and ordered to pay $550,000 in fines and approximately $25 million in taxes, interest, and penalties for

bankruptcy fraud and tax evasion. The day before he filed for bankruptcy, he had knowingly and fraudulently transferred and concealed more than $3 million held in an online trading account and a bank account. He had transferred the funds through a series of bank deposits, wire transfers, and cashier's checks and used a shell company to help hide assets. Sometimes fraud cases can be very complex and involve multiple types of fraud. For example, in one recent case, a Beverly Hills lawyer was convicted of three counts of mail fraud, seven counts of wire fraud, and five counts of lying in a court hearing. In an elaborate fraudulent scheme, the lawyer had purchased a yacht for $1.9 million, sold it to two partners to drive up its insurance value, and then had a company he owned repurchase the yacht and insure it for $3.5 million. Finally, he and his partners sank the yacht and tried to collect the insurance. BUT WHAT IF. . . Former Mets outfielder Lenny Dykstra went to court for fraud in 2012. While Dykstra owned a mansion formerly owned by Wayne Gretzky, he claimed that he was over $31 million in debt and his total assets amounted to only $50,000. Thus, he was seeking to file for bankruptcy. If Dykstra secretly hid and sold $400,000 worth of possessions yet on the stand said he had only a few items put into his storage unit, would he be accountable for only bankruptcy fraud or other types of fraud as well? Alternatively, if Dykstra had reviewed the sold, stored, and destroyed items with a bankruptcy trustee, would he be liable for fraud at all? A fraudulent crime that has recently come into the public eye is pretexting. Pretexting can be defined as using or causing others to use false pretenses, fraudulent statements, fraudulent or stolen documents, or other misrepresentations, including posing as an account holder or employee of a telecommunications carrier, to obtain the telephone records of another. Pretexting entered the national lexicon in 2006 when news broke that the investigators hired by Hewlett-Packard's board of directors to locate the source of several leaks to the media were engaging in this practice. Under the federal Telephone Records and Privacy Protection Act of 2006, anyone convicted of employing fraudulent tactics to persuade phone companies to hand over confidential data about a customer's calling habits can be sent to prison for up to 10 years. Some states also have statutes outlawing pretexting. Both individuals and businesses can be victims of fraud. To minimize the chances that your firm will be a victim of fraud, review the fraud prevention tips in Exhibit 6-2 very carefully. Exhibit 6-2Fraud Prevention Tips Red Flags Suggesting Possible Fraud When you are looking at a brochure offering an investment opportunity that seems almost too good to be true, it may indeed not be as good as it seems, especially if it contains these red flags of fraud: No independent proof of profitability: The brochure provides the investment strategy but includes no details that can be verified, such as names and addresses of specific companies in which it invests. Control by a single person. No audited financial statements and no evidence of internal controls. Unusually high rates of return: The rates of return are significantly higher than those for other funds with a similar investment strategy. New

investors' reliance primarily on existing investors in deciding to invest. False Assurances That an Investment Opportunity Is Not Fraudulent Long-time existence of investment opportunity: A Ponzi scheme can operate for a long time. As long as the company keeps getting new investors, it can continue to use the new investors to pay off the few who insist on collecting their returns. Many investors may be content to accumulate paper profits, especially if there is a financial incentive for reinvestment of profits. For example, the Financial Advisory Fund had been in business for almost 20 years before its fraudulent foundation was uncovered. A list of names and addresses of satisfied investors you can contact: All such schemes will have some satisfied investors who have received payments from the new investment money. Membership in the Better Business Bureau: Any company can pay to join. If most of the investors have not attempted to withdraw their funds and the company is still getting new investments, there will be no disgruntled investors to complain to the BBB. A report of profitability from Dun & Bradstreet: Dun & Bradstreet does not do an independent financial audit of a company's profits. As stated on its website, Dun & Bradstreet simply provides the information regarding profits that it receives from companies. Acceptance of money rolled over from IRAs: There is no government check on the soundness of firms that roll over IRAs. Bank references: If a firm simply has a large amount of money in a checking account in a bank and has never sought a loan from the bank, the bank would have no reason to do any due diligence on the firm. Also, if the owner of the firm is personable and the account has never been overdrawn, the bank personnel may well give the firm a good reference. Glossy brochures and television ads: All you need for both is some money and the knowledge that many people may be overly impressed by a fancy brochure or ad campaign. These tips come from Barry Minkow, who went from starting his own carpet cleaning business at the age of 16, to taking this multimillion-dollar company public at the age of 20, to facing a 23-year prison sentence and $26 million victim restitution payment at the age of 21 for massive fraud and theft perpetuated on behalf of his company, to now being a pastor and the cofounder of the Fraud Discovery Institute. The fascinating story of how Minkow, through fraudulent Ponzi schemes, check kiting, and theft, managed to build the multimillion-dollar ZZZZ Best Carpet Cleaning Company by the age of 20 is contained in his book, Cleaning Up. The book also provides insights into why some people may commit white-collar crimes, describes many of the long-running frauds Minkow helped to uncover since deciding to use his understanding of the perpetuation of fraud to help uncover and prevent it, and how he became a preacher. Unfortunately, Minkow's conversion was not permanent, and in 2014 he was sentenced to five years in prison for embezzling $3 million from his San Diego church congregation. Ponzi schemes are another form of fraud that Americans are increasingly seeing discussed in the news. A Ponzi scheme is a fraudulent operation in which the operator, an individual or organization, pays returns to its investors from new capital paid to the operators by new investors rather

than from profit earned by the operator. In early 2009, Bernie Madoff, the perpetrator of one of the largest Ponzi schemes to date, was charged with 11 felony charges, including securities fraud, investment adviser fraud, mail fraud, wire fraud, three counts of money laundering, false statements, perjury, false filings with the United States Securities and Exchange Commission, and theft from an employee benefit plan. Global Context Digital Archive Japan/Alamy Stock Photo Embezzlement and Bribery in China On March 8, 1982, in response to a concern about a rise in white-collar crimes, Chinese officials added a resolution entitled “Severely Punishing Criminals Who Do Great Damage to the Economy” to the Chinese Criminal Code. The provision targeted top-ranking officials by providing that any state functionaries who extort, accept bribes, or exploit their office will no longer receive the fixed-term punishment (usually 10 years) allocated for bribery and extortion. Instead, those officials found guilty of extortion and accepting bribes would be sentenced to life imprisonment or possibly put to death. Bank fraud is another white-collar crime that may be punishable by death. In 2004, China executed four people, including employees of two of its Big Four state banks, for fraud totaling $15 million. Three of the cases involved China Construction Bank. A former accounting officer at this bank worked with others to steal 20 million yuan ($2.4 million) from the bank by using fake papers. He and an accomplice were executed, along with another Construction Bank employee who was found to have taken 20 million yuan from the bank in an unrelated case. Additionally, an official employed by the Bank of China was executed for cheating. The precise number of people executed in China is not made available to the public. Estimates range from 5,000 to 10,000 a year, for crimes including murder, corruption, and, on occasion, even bottom-pinching. Most are executed by a single shot in the back of the head. Such punishments may seem extreme, but the reaction of the Chinese to the increase in white-collar crime reflects the culture’s unusually great concern for social harmony. Madoff ultimately pled guilty to all 11 counts and was subsequently sentenced to a term of imprisonment of 150 years for this crime, which was estimated to have cost investors losses of $18 billion. As of April 2014, the government had seized $2.35 billion in corporate and personal assets from Madoff that were to be distributed to victims of the fraud. Even though Madoff was prosecuted in 2009, it wasn’t until 2014 that five of his former aides were convicted on grounds that they had helped him conceal his massive fraud for years. In a trial that lasted five months, back-office director Daniel Bonventre, portfolio managers Annette Bongiorno and Joann Crupi, and computer programmers Jerome O’Hara and George Perez pled guilty on all counts, including securities fraud and conspiracy to defraud clients. Prior to this trial, nine other people pled guilty in connection with Madoff’s fraud. Page 122Page 123 A $300 million Ponzi scheme involving real estate investments led to Fred “Dave” Clark Jr., the founder and CEO of Cay Clubs, being convicted on three counts of bank fraud and making a false statement to a financial institution and one count of obstructing the SEC by lying to

the agency. In 2016, he was sentenced to 40 years in prison and fined $303.8 million for the bank fraud and $3.3 million for obstruction charge. He also was ordered to forfeit $2.6 million in overseas assets, and to to pay the U.S. Internal Revenue Service over $1.5 million in restitution for taxes owed on unreported income. The way this crime unfolded was that Cay Clubs sold condos as condo-hotel vacation units in the Keys, Clearwater, and Las Vegas and promised renovations and big payouts to the investors, but, instead, used new buyers' money to pay lease-back fees owed to earlier buyers while extracting $22 million from the company. Clark used the money to buy waterfront homes, cars, and planes. The scheme lasted almost four years before collapsing on itself. Embezzlement Joe is Kathleen's attorney. Kathleen gave Joe $5,000 to put in escrow, an account to which Joe will have access, although the money is not his to use as he pleases. Suppose Joe takes some of that money out of the account and uses it to gamble, and he fixes the records to cover up the fact that he has used some of the money for his personal use. He has committed the crime of embezzlement, the wrongful conversion of another's property by one who is lawfully in possession of that property. Embezzlement is distinguished from larceny because the individual did not take the property from another; he was already in possession of the property. Embezzlement usually occurs when an employee steals money. Thus, it is often employees in banks who commit the crime. However, as the recent embezzlement of $6.9 million from the American Cancer Society demonstrates, even nonprofit organizations are vulnerable to the crime of embezzlement. Even the Girls Scouts have been victims of embezzlement. A Girl Scout Troop leader pocketed the proceeds of her troop's annual Girl Scout Cookie Sale, as well as a portion of a donation made to the troop by a family member of a deceased troop leader. The embezzlement came to light only when the troop was unable to afford to participate in their ordinary scouting activities.5 White-collar crimes such as embezzlement are a problem in many countries. For example, the Chinese government, which has been focusing on economic crimes, caught employees in two major Chinese banks altering deposit slips and bank orders to direct the money to personal accounts throughout China. Those employees received death sentences for embezzlement, as discussed in the Global Context box. Page 124 Computer Crimes The term computer crime refers broadly to any wrongful act that (1) is directed against computers, (2) uses computers to commit a crime, or (3) involves computers. Computer crime is not necessarily a new kind of crime but is, instead, a new way of committing traditional crimes. Fraud, for example, is a crime that has existed for centuries. Today, online auctions, such as eBay, are a common source of fraud in the United States. But electronic fraud is not the only costly computer related crime. According to the FBI, dealing with viruses, spyware, PC theft, and other computer crimes cost U.S. businesses $67.2 billion. Computer crimes are often difficult to prosecute, in large part because they are difficult to detect. A computer crime could be committed by an insider, such as an

employee, or by an outsider, such as a hacker—a person who illegally accesses or enters another person's or a company's computer system to obtain information or to steal money. In addition, computer systems are quite open to attack. The American Society for Industrial Security has reported that the losses from computer crimes in a single year were more than $250 billion for U.S. companies. Furthermore, the attacks are frequent. The IRS alone detects 800 to 1,200 cases of computer system misuse annually. A cyber terrorist is a hacker whose intention is the exploitation of a target computer or network to create a serious impact, such as the crippling of a communications network or the sabotage of a business or organization. The activity of a cyber terrorist can have an impact on millions of citizens if the terrorist's attack is successful, particularly if it involves the computer systems of a major stock exchange, any bank, or any federal agency or government. In an attempt to aid prosecutions of computer crimes, Congress passed the Counterfeit Access Device and Computer Fraud and Abuse Act of 1984 (also know as the Computer Fraud and Abuse Act, or CFAA). The act prohibits six broad categories of computer crimes: Unauthorized use of or access to a computer to obtain classified military or foreign policy information with the intent to harm the United States or to benefit a foreign country. Unauthorized use of a computer to collect financial or credit information protected under federal privacy law. Unauthorized access to a federal computer and the use, modification, destruction, or disclosure of data it contains or the prevention of an authorized person's use of such data. Alteration or modification of data in financial computers, causing a loss of $1,000 or more. Modification of data that impedes medical treatment to individuals. Fraudulent transfer of computer passwords or similar data that could aid unauthorized access that either (a) affects interstate commerce or (b) permits access to a government computer. Computer crimes falling into the first category are felonies, whereas the others are misdemeanors. The National Information Infrastructure Protection Act of 1996 amended the Computer Fraud and Abuse Act. One of the major changes to the CFAA is the substitution of the term protected computers for federal interest computers so that the statute now protects any computer attached to the Internet. In a further attempt to aid prosecution of computer crimes, the U.S. Department of Justice formed the Computer Crime and Intellectual Property Section (CCIPS) in its Criminal Division. Attorneys in this division prosecute only federal computer crimes. They also coordinate their activities with numerous government entities, the private sector, scholars, and foreign representatives in an attempt to develop a global response to computer crime. Destruction of data is one of the most serious problems facing companies today. A virus is a computer program that rearranges, damages, destroys, or replaces computer data. Thus, if an employee or a hacker creates and releases a virus, a company can easily lose vital information. Until recently, the most economically destructive computer crime to date was the creation of the Love Bug virus. In May 2000, the virus spread rapidly throughout the world by email.

Once the email was opened, it destroyed files on the user's computer, and then the virus sent itself to every address in that computer's email address book. In the end, the virus caused more than $10 billion in damages and halted computers in major companies and government agencies worldwide. However, over the weekend of May 12, 2017, unknown cyberhackers launched "Wanna Cry," believed to be, as of when this book went to press, the biggest online extortion attack ever recorded. The global "ransomware" attack struck governments, universities, and private firms in over 150 countries, causing a wide range of problems. For example, in London, a fifth of the National Health Services that manage the hospitals were hit, leading to thousands of canceled appointments and operations. E-Commerce and the Law E-Commerce and the Law Crime has moved online alongside the digitization of society. Ever since personal information became accessible online, criminals have moved to exploit it. Instead of lifting financial statements from mailboxes, thieves could now pilfer private data from their personal computers. Computer crime has only grown in frequency and scope. In 2017, credit reporting agency Equifax announced it had been hacked and the personal information of over 147.9 million U.S. citizens had been compromised. If you've ever had a credit card or a loan before 2017, chances are, hackers have your name, birth date, and social security number. Computer crime is not solely about stealing personal information. As recently as 2018, researchers found sensitive corporate documents, such as blueprints, from automakers such as Tesla, Toyota, and Volkswagen sitting on the internet. But stealing information isn't the only trick hackers play today. According to the federal Cybersecurity and Infrastructure Security Agency (CISA), the latest growing cybersecurity threat is ransomware. Ransomware is a type of malicious software that encrypts data on breached computers. The only one who can undo the encryption is the hacker. In other words, the hacked firm can no longer access their data. California University was a ransomware victim in 2020 and paid the hackers $1.14 million to restore their data access. In another 2020 malware incident, Finastra, a fintech company that serves more than 90 of the top 100 banks globally, opted to shut down their servers instead of paying the ransom. Although Finastra restored their digital infrastructure using backups, their clients experienced outages until the restoration was finished. As you can see, poor cybersecurity can be very costly. In May of 2021, DarkSide Ransomware Gang staged a ransomware attack on the Colonial Pipeline that shut down the oil pipeline the energy company manages until the firm paid a $4.4 million ransom in Bitcoin, of which $2.3 million was recovered by the FBI's Digital Extortion Task Force. Ransomware attacks are such a problem that, on October 8, 2021, the president signed intolaw the bipartisan K-12 Cybersecurity Act of 2021 to provide school districts with IT security resources to combat threats and protect themselves against cyberattacks including ransomware. Page 125 Companies can try to prevent the destruction of data by installing virus detection programs on their computers. However, the detection programs recognize only previously existing

harmful files. As a result, if someone creates a new virus, the detection program is useless. When an employee uses his or her computer in a manner not authorized by the employer, the employee has committed a crime. Employers, then, must clearly communicate with employees about authorized versus unauthorized behavior. For example, if an employee uses her work computer to run her own personal business on the side, her employer may argue that she is engaging in theft because she is not using her computer in an authorized manner. Thus, when you become a business manager, you will want to make sure that you explicitly list acceptable computer uses, along with the penalties associated with unauthorized use.

Corporate Criminal Liability LO 6-3 Recognize who can be held responsible when a corporate crime is committed. An individual or a corporation can be charged with and convicted of a crime. However, there has been much debate over whether corporations should be held criminally responsible. Under the common law, a corporation could not be considered a criminal because it was not an actual person and thus did not have a mind. Consequently, it could not meet the mens rea (guilty-mind) requirement for a crime. Slowly, however, courts began to impose liability on corporations for strict-liability offenses, those offenses that do not require state of mind. Next, courts imposed liability on corporations by imputing the state of mind of the employee to the corporation. Currently, corporations can be held criminally accountable for almost any crime. However, they cannot be held liable for crimes that are punishable only by a prison sentence. For a corporation to be held criminally liable for the acts of an employee, the prosecutor must show that (1) the employee was acting within the scope of her or his employment; (2) the employee was acting with the purpose of benefiting the corporation; and (3) the act was imputed to the corporation. In addition to corporations having criminal liability, corporate executives may also be personally liable for a business crime. The beneficiary of the crime is irrelevant because corporate executives and officers can be found to be personally liable regardless of whether the crimes were committed for their personal benefit or for the benefit of the corporation. Page 126 Also, under the “responsible corporate officer” doctrine, a court may assess criminal liability on a corporate executive or officer even if he or she did not engage in, direct, or know about a specific criminal violation. As Case 6-3 demonstrates, corporate executives sometimes have the responsibility and power to ensure the company’s compliance with the law. If the executive fails to meet this responsibility, the executive can be held criminally liable. CASE 6-3 UNITED STATES v. PARK United States Supreme Court 421 U.S. 658 (1975) FACTS: Defendant Park, the president of a national food-chain corporation, was charged, along with the corporation, with violating the Federal Food, Drug, and Cosmetic Act by allowing food in the warehouse to be exposed to rodent

contamination. Park had conceded that his responsibility for the “entire operation” included warehouse sanitation, but he claimed that he had delegated the responsibility for sanitation to dependable subordinates. He admitted at trial that he had received a warning letter from the Food and Drug Administration regarding the unsanitary conditions at one of the company’s warehouses. The trial court found the defendant guilty. The court of appeals reversed. The case was appealed to the U.S. Supreme Court. ISSUE: Can corporate executives be criminally liable for failing to ensure a company’s compliance with the law? REASONING: The Supreme Court has noted that the only way corporations can act is through their individual employees. The act in question, the Federal Food, Drug, and Cosmetic Act, requires stringent, affirmative actions on the part of corporate executives, but these standards are justified by the public interest in food safety. We expect executives such as Park to exercise appropriate authority and demonstrate supervisory responsibility. There is considerable evidence that Park had a duty to ensure sanitary conditions and that he violated that duty by failing to ensure that those to whom he delegated responsibility did their jobs. The Court said: “[T]he requirements of foresight and vigilance imposed on responsible corporate agents are beyond question, demanding, and perhaps onerous, but they are not more stringent than the public has a right to expect of those who voluntarily assume positions of authority in business enterprises whose services and products affect the health and well-being of the public that supports them.” DECISION AND REMEDY: The U.S. Supreme Court reversed the appellate court’s reversal of the trial court’s conviction, finding that corporate executives can be criminally liable for failing to ensure a company’s compliance with the law. SIGNIFICANCE OF THE CASE: This case signaled to corporate officials that they could no longer use ignorance as a defense, because a court will hold high-level corporate actors responsible for their company’s failure to comply with the law, even if they were unaware of what was going on within their company. CRITICAL THINKING Given the rule laid down in this case, could the defendant have presented any evidence that would have led to a different decision? ETHICAL DECISION MAKING Suppose you were in Park’s position in this case. You allegedly allowed food in your warehouse to be exposed to rodent contamination. If you were guided by the public disclosure test, what would you decide to do? Page 127 Since United States v. Park, the general rule that corporate executives may be held accountable for the crimes arising from their failure to meet their responsibility has remained intact. The rule has, in fact, broadened so that now executives can be held criminally liable for offenses that we generally do not think of as crimes. For example, in United States v. Iverson,6 a corporate officer of a waste treatment facility was convicted and sentenced for violating the Clean Water Act after he ordered employees to dispose of wastewater illegally. This case demonstrates that corporate executives can be sentenced not only for committing the common law crimes that we have traditionally understood to be criminal offenses but also for violating provisions of regulatory statutes

that permit criminal sanctions. In such cases, vicarious liability, or liability imposed on one person for the acts of another, is assessed to the corporate executive. In fact, courts have held that employers are vicariously liable for the wrongful acts of their employees if the employer directed, partook in, or authorized the wrongful act. CASE Nugget Can a Corporate Executive Be Held Liable for Murder or Manslaughter? While we do not typically think of murder or manslaughter as being white-collar crimes, if corporate employees's decisions lead to the deaths of customers, the corporate decision makers may well find themselves charged with murder or manslaughter. A good illustration of this situation is the indictment in 2018 of five corporate employees and a corporation because of the death by decapitation of a 10-year-old child riding a 17-story waterslide. The slide in question required two or three riders to be strapped onto a raft, and according to the park's website, the raft would "slide down a jaw-dropping 168-foot-7-inch structure, only to be blasted back up a second massive hill and then sent down yet another gut-wrenching 50-foot drop for the ultimate in water slide thrills." The child was decapitated when the raft few into the air and collided with overhead hoops and netting attached to the slide. The indicted parties included the two designers of the slide, one of whom was a co-owner of the park, the former operations manager of the park, and the companies that constructed the slide and operated the park. Allegations in the indictment included a claim that one of the defendants who was responsible for many of the design decisions had no technical and engineering expertise and that there were multiple flaws in the design, some of which caused the design to violate long-standing safety standards in the industry. The indictment also alleged that the constructions was rushed, leading to its opening in an unfinished and unsafe condition, and that employees knew of similar accidents with the slide causing injuries to at least 10 other riders, and that defendants lied to investigators.7 In 2019, however, the charges were dismissed due to multiple abuses by the state attorney general in the grand jury process, including the presentation of impermissible evidence to the grand jury. Despite the dismissal, however, the case is worth thinking about because it reminds us that there is always the possibility that manslaughter charges will be filled when management decisions lead to death. Cases charging corporate executives or corporations with murder or manslaughter are certainly uncommon. The first such charges were filed in a case arising out of the death of an employee from cyanide poisoning. The now defunct Film Recovery Systems was charged with involuntary manslaughter, and two corporate officials and two management-level employees were charged with murder. The indictments alleged that the company employed illegal workers who did not speak English, could not read warning labels, were not given the necessary safety equipment, and were forced to work in conditions that were likely to lead to death or serious injury. While the prosecution was unsuccessful, and there have not been many attempts to pursue such charges since that time, perhaps the case against the Schlitterbahn Water Park is the

beginning of a new turn in regulating corporate behavior.8 Source: Marilia Brocchetto and Melissa Gray., CNN, Kansas water park executives charged with Murder in boy's death, https://www.cnn.com/2018/03/27/us/schlitterbahn-waterpark-death-arrests/index.html (March 27, 2018); Schlitterbahn faces criminal case after Kansas boy decapitated on 17-story waterslide, Dallas News, https://www.dallasnews.com/news/us-news/2018/03/23/schlitterbahn-faces-criminal-case-after-kansas-boy-decapitated-17-story-waterslide.

Criminal Procedure LO 6-4 Outline the basic steps of a criminal proceeding. Criminal procedure differs from civil procedure in several key ways. First, the government, referred to as the prosecutor, always brings the criminal case, whereas in a civil case, the party filing the case, the plaintiff, can be an individual, business, or government entity. Second, the outcome of each is different. In a criminal case, the objective is punishment, so the defendant may be fined or imprisoned; in a civil case, the objective is to remedy a wrong done to the plaintiff, so the defendant either will have to provide compensation to the plaintiff or may be subject to an equitable remedy such as an injunction or order for specific performance. Third, because the potential impact of losing a criminal case is so much more serious than the impact of losing a civil case, the Constitution provides a number of safeguards for the criminal defendant. These safeguards are set forth in Exhibit 6-3. Exhibit 6-3Constitutional Provisions That Safeguard Criminal Defendants' Rights AMENDMENT PROVISIONS Fourth Protection from unreasonable search and seizure. Restrictions on warrants. Fifth Prohibition of double jeopardy. Right not to incriminate oneself. Right to due process. Sixth Right to a speedy and public trial. Right to a trial by an impartial jury of one's peers. Right to be informed of the accusations against oneself. Right to confront witnesses. Right to have witnesses on one's side. Right to counsel at various stages of the proceedings. Eighth Freedom from excessive bail. Freedom from excessive fines. Freedom from cruel and unusual punishment. Fourteenth Extension of the right to due process in all state matters. Extension of most constitutional rights to defendants at the state level. Pretrial Procedure Prior to an arrest, grand juries may conduct criminal investigatory proceedings or issue a grand jury subpoena for company records. Criminal proceedings generally begin when an individual is arrested for a crime. A law enforcement officer must perform the arrest. This officer is often a police officer but may also be an agent of another government agency, such as the Bureau of Alcohol, Tobacco and Firearms; the Federal Bureau of Investigation; or the Immigration and Naturalization Service. A law enforcement officer should obtain an arrest warrant before an individual is

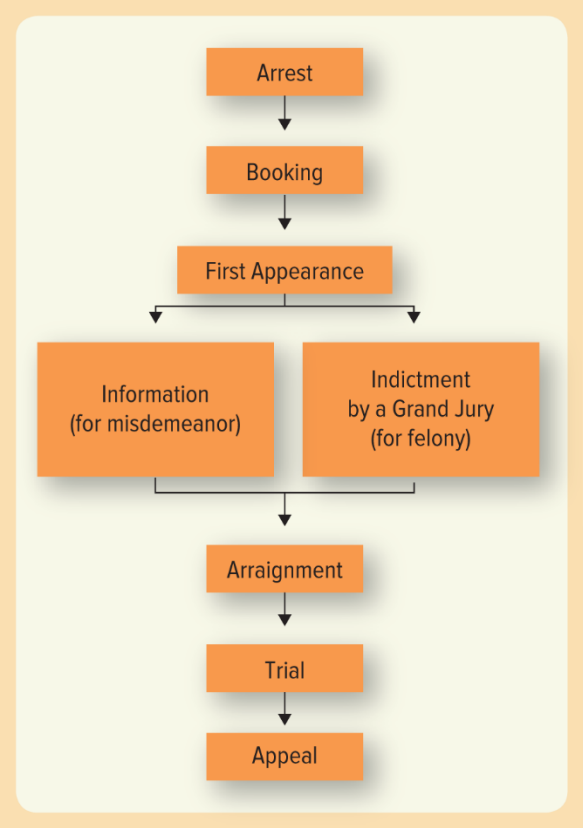
taken into custody. Ordinarily, to obtain an arrest warrant, the law enforcement agent must demonstrate that there is probable cause, or a likelihood, that a suspect committed or is planning to commit a crime. A magistrate, the lowest-ranking judicial official, issues the arrest warrant. In certain circumstances, however, courts have recognized that law enforcement agents can arrest a suspect without a warrant if the officer believes there is probable cause but not enough time to obtain the warrant. Page 129 When law enforcement agents arrest individuals, the officers must inform the individuals of their Miranda rights. If they fail to do so, any information a defendant offers at the time of the arrest is not admissible at trial. To comply with the Supreme Court's requirements for protecting a citizen's rights, a law enforcement officer must inform the defendant of the following facts before questioning: "You have the right to remain silent and refuse to answer any questions." "Anything you say may be used against you in a court of law." "You have the right to consult an attorney before speaking to the police and have an attorney present during any questioning now or in the future." "If you cannot afford an attorney, one will be appointed for you before the questioning begins." "If you do not have an attorney available, you have the right to remain silent until you have had an opportunity to consult with one." "Now that I have advised you of your rights, are you willing to answer any questions without an attorney present?" The Miranda rights are not absolute. In fact, the Supreme Court has several times created exceptions to the Miranda rights. For example, in New York v. Quarles,9 the Court created a public-safety exception to the Miranda rights. This exception allows statements to be used at trial, even if a person was not informed of his or her Miranda rights, if the need to protect the public is served by the admissibility of the statements in question. After being arrested and read their Miranda rights, defendants are taken to the police station for booking, a procedure during which the name of the defendant and the alleged crime are recorded in the investigating agency's or police department's records. After the prosecutor files the complaint, the defendant makes the first appearance, which is the appearance before a magistrate who determines whether there was probable cause for the arrest. If the magistrate ascertains that probable cause did not exist, the individual is freed. If the defendant committed a minor offense and pleads guilty, the magistrate sentences the individual. However, if the defendant claims innocence, the magistrate ensures that the defendant has a lawyer, or appoints one, if necessary, for an indigent defendant, and sets bail. Bail is the amount of money defendants pay to the court on release from custody as security that they will return for trial. Next, the prosecutor has a choice: Should the case be prosecuted? The Principles of Federal Prosecution, established by the U.S. Department of Justice, suggest that at the federal level the decision to prosecute depends on two primary factors: (1) whether the evidence is sufficient to obtain a conviction and (2) whether prosecuting the case serves a federal interest. If the prosecutor decides not to go forward with the case, the defendant

may still be liable for his or her actions in civil court. If the prosecutor chooses to proceed with a criminal action, the prosecutor must demonstrate the likelihood that the defendant's actions and intent meet the elements of a crime by charging the defendant with a crime through an information or an indictment. For a misdemeanor, the prosecutor must present to the magistrate evidence sufficient to justify prosecution of the defendant. This is done through a written document called an information, a formal accusation stating the facts and specifying the violation of criminal law. However, for a felony, the prosecutor must present a grand jury with evidence adequate to justify bringing the defendant to trial. If the grand jury agrees that the evidence is adequate, it issues an indictment, a written accusation of the crime allegedly committed by the defendant. Note that the grand jury does not determine guilt. It is simply a group of citizens who consider evidence of criminal conduct presented by the prosecutor and then determine whether there is enough evidence to try the defendant for the crime. In federal cases, a defendant accused of a felony has a constitutional right to a grand jury indictment. However, a felony prosecution may proceed by information if the defendant waives that right. For instance, in a high-profile case in which the defense attorney is trying to work out a deal with the prosecution, the defendant may ask for the case to proceed by information. Federal misdemeanor cases may proceed by indictment or information. Page 130 CASE Nugget Finally, U.S. Supreme Court Holds that the 6th Amendment Requires a Unanimous Verdict Ramos v. Louisiana 140 S. Ct. 1390 (2020) In the United States, the right to a jury trial is fundamental to justice. But are unanimous jury verdicts required to convict? Forty-eight states and the federal government believe they are. Until 2020, however, Louisiana and Oregon convicted felons for serious offenses, even with a 10-2 verdict. This changed in Ramos v. Louisiana, where the Supreme Court held unanimous verdicts are required for serious offense convictions. Delivering the Supreme Court's opinion, Justice Gorsuch began with the historical reason why Louisiana and Oregon allowed nonunanimous verdicts. Nonunanimous verdicts were endorsed at Louisiana's 1898 constitutional convention, the purpose of which was to "establish the supremacy of the white race." The U.S. Senate had passed a resolution to investigate whether Louisiana was excluding Black people from juries. The 10-2 conviction requirement allowed Louisiana to continue convicting Blacks while ostensibly allowing Black jurors. Similarly, Oregon's nonunanimous verdict can be traced back to the Ku Klux Klan's rise in the 1930s. Both states had racially discriminatory motives. Justice Gorsuch then recounted the meaning of "jury trials" when the Sixth Amendment was written. He noted that by then jury trials implied unanimous verdicts for 400 years. Although the Sixth Amendment does not explicitly require unanimous verdicts, based on the common law and the Founder's intentions, unanimous verdicts were necessary. Acknowledging the Court's mistake, Justice Gorsuch and four other justices abrogated Apodaca and Johnson, holding that the Sixth Amendment required unanimous verdicts to convict for serious offenses and

that the requirement applied to all states under the Fourteenth Amendment. If the criminal trial takes place in state court, the defendant may or may not have access to a grand jury. The U.S. Supreme Court has held that indictment by a grand jury is not a fundamental right; thus, states are not required to offer grand juries. About half the states still require felony prosecutions to be initiated by grand jury indictments; most of the rest use information as the method for commencing prosecution. If the grand jury issues an indictment, the defendant appears in court to answer the indictment in a proceeding called the arraignment. At this time, the defendant enters a plea of guilty or not guilty. A defendant may also enter a plea of nolo contendere, whereby the defendant does not admit guilt but agrees not to contest the charges. The advantage of a nolo contendere plea over a guilty plea is that the former cannot be used against the defendant in a civil suit. If the defendant pleads not guilty, his case will be heard before a petit jury, which is a fact-finding jury. At any time, the prosecutor and defendant can make a plea bargain, an agreement in which the prosecutor agrees to reduce charges, drop charges, or recommend a certain sentence if the defendant pleads guilty. Plea bargaining benefits both parties. The defendant gets a lighter sentence, and the prosecution saves time and resources by not trying the case. Businesspeople who commit crimes that affect business often engage in plea bargaining to avoid the publicity associated with a trial and the risk of a severe sentence. Trial Procedure If the case goes to trial and the crime is a felony or a misdemeanor punishable by six months or more in prison, the defendant has a constitutional right to a jury trial. In most states, if the defendant waives the right to a jury trial, the judge will hear the case. When a judge is the fact finder in a case, the trial is called a bench trial. Page 131 In a criminal trial, the prosecutor has the burden of proof and the defendant does not have to prove anything. The burden of proof has two elements: the burden of production of evidence and the burden of persuasion. To meet the burden of production of evidence, the prosecution must produce any tangible evidence and testimony that prove the elements of the crime that the defendant allegedly committed. Along with producing evidence, the prosecution also has the burden of persuasion: The prosecutor must persuade the jury beyond reasonable doubt that the defendant committed the crime. The burden of proof, then, is higher in a criminal case than in a civil case because, in a civil case, the burden of persuasion requires only that the claim is supported by a preponderance of the evidence. The prosecution presents the government's case first, introducing evidence and examining witnesses to prove beyond a reasonable doubt that the defendant committed the crime. Once the prosecution rests its case, it is the defendant's turn. The defendant either (1) can show, through examination of witnesses and introduction of evidence, that the prosecution did not meet its burden of proof or (2) can present an affirmative defense. An affirmative defense is a reason the defendant, even though he or she committed the physical acts alleged by the prosecution, should be excused from responsibility for those actions. Exhibit 6-4 lists some

common affirmative defenses. Exhibit 6-4Affirmative Defenses to Crimes Infancy A person who is not yet a legal adult may use this defense to defuse the guilty-mind requirement of a crime. Mistake of fact The defendant says his or her honest and reasonable mistake about a fact relevant to the commission of the crime negates the idea of a guilty mind. Intoxication The defendant says he or she took an intoxicant without awareness of its likely effect, mistook its identity, or took the intoxicant under force. Insanity The defendant had a severe mental illness that substantially impaired the defendant's capacity to understand and appreciate the moral wrongfulness of the act. Duress The defendant says he or she was forced to perform an act against his or her will. Entrapment The defendant would not have committed the crime or broken the law if not induced or tricked into doing so by law enforcement officers. Necessity The defendant was acting to prevent imminent harm, and there was no legal alternative to the action he or she took. Justifiable use of force Use of force was necessary to prevent imminent death or great bodily harm to the defendant or to another or to prevent the imminent commission of a forcible felony. After the jury hears the case, it deliberates and tries to reach a verdict. A jury that is unable to reach a verdict is known as a hung jury. If the jury finds the defendant not guilty, the accused is acquitted and released. If the jury returns a guilty verdict, the judge sets a date for sentencing. Posttrial Procedure Page 132 If the petit jury returns a verdict of not guilty, the government cannot appeal the acquittal. However, if the verdict is guilty, the defendant may appeal the verdict by claiming that a prejudicial error of law occurred at the original trial. If there is no appeal, the defendant will be sentenced after the judge has received additional information relevant to sentencing. Before 1991, sentencing was indeterminate, with judges allowed but not required to engage in free-form fact finding before selecting the appropriate punishment within broad statutory ranges. In 1991, however, there was a shift to determinate sentencing, under which federal sentences are determined largely by sentencing guidelines prescribing a specific range of possible penalties for each crime. Judges are given certain factors to consider in sentencing, such as the defendant's criminal record. Guidelines have also been established for white-collar crimes, once again allowing judges to consider individual factors, such as the company's history of past violations and cooperation with federal investigators. On April 9, 2015, the United States Sentencing Commission approved new sentencing guidelines for business fraud crimes in response to "longstanding concerns [of judges and lawyers] that the guidelines do not appropriately account for harm to victims, individual culpability, and the offender's intent." One of the most significant changes involves how "intended loss," or the financial harm that was intended to result from the fraud, is understood. It is now interpreted as the loss that the defrauder intended to cause and not necessarily only the loss that was actually caused. In another major change, the financial situation of the victims of the fraud is now being considered. This means that if a person defrauds another person who experienced

“financial hardship” as a result of the fraud, such as bankruptcy, harm to the ability to gain credit, substantial losses in investments such as retirement or education, or substantial changes in living arrangements such as having to move into a less-expensive home, harsher sentences may be invoked. Many states have adopted sentencing guidelines similar to the federal guidelines. Exhibit 6-5 summarizes the steps of a criminal procedure. Exhibit 6-5Steps in a Criminal Procedure



Tools for Fighting Business Crime LO 6-5 Describe the laws that attempt to prevent white-collar crime. Although clearly a significant number of business-related crimes can be committed, certain federal laws help fight such crime. Three federal laws that have been somewhat successful in this battle are RICO, the False Claims Act, and the Sarbanes-Oxley Act of 2002. Although these laws are currently extremely powerful white-collar-crime laws, RICO and the False Claims Act were created with different purposes in mind. Sarbanes-Oxley, however, was created specifically to combat white-collar crime. RICO One of the most important tools for fighting white-collar crime is Title IX of the Organized Crime Control Act of 1970: the Racketeer Influenced and Corrupt Organizations (RICO) Act.

Although the statute was originally enacted to combat organized crime, in effect it prevents legitimate businesses from serving as covers for racketeering. This statute prohibits persons employed by or associated with an enterprise from engaging in a pattern of racketeering activity. Anyone whose business or property has been damaged by this pattern of racketeering activity can sue to recover treble damages and attorney fees in a civil action. Demonstrating a claim under RICO requires proof of a pattern of racketeering. Courts have defined a pattern as more than one action. Thus, a one-time violator could not be prosecuted under RICO because there could be no pattern as yet. Some courts additionally have found that a pattern requires continued criminal activity over a "substantial" period of time. Although pattern is restricted to more than one act, racketeering has been defined broadly to include almost all criminal actions, such as acts of violence, fraud, bribery, securities fraud, and the provision of illegal goods and services. Therefore, RICO is an extremely effective tool in combating white-collar crimes. In addition to being held civilly liable under RICO, a violator may also be subject to RICO's criminal penalties. A person found to have violated the act may be subject to a fine of up to $25,000 per violation, imprisonment for up to 20 years, or both. The False Claims Act Since 1986, private citizens have been using the False Claims Act to sue employers on behalf of the government for fraud against the government. For example, an employee in a health care facility might realize that his employer is submitting fraudulent claims to Medicare. The employee can bring a suit against the employer on behalf of the government for fraud against the government. If an employee realizes that their employer is committing fraud against the government, they must first notify the government of their intent to file the case on behalf of the government. If the government chooses to intervene and prosecute the case itself, with the help of the employee, the citizen would receive 25 percent of the amount recovered. If the government does not opt to get involved, and the citizen continues with the case on behalf of the government, she receives 30 percent. Certainly, an employee who brings a suit against his employer might be worried about retaliation, such as being fired or demoted. Thus, the act provides protection for employees who use the law. If an employer is found guilty of retaliation, the employer may be forced to pay the employee twice the amount of back pay plus special damages. In a 2018 case that was seen as a victory for employers,10 however, the 10th Circuit Court of Appeals ruled that ". . .the False Claims Act's anti-retaliation provision unambiguously excludes relief for retaliatory acts occurring after the employee has left employment." Page 134 The biggest reward thus far under the act was the approximately $51 million share that four whistleblowers and their attorneys received for blowing the whistle on a Swiss drug company, Serono, for participating in a marketing scheme that resulted in physicians illegally prescribing over $11.5 million worth of a drug that was paid for by Medicaid. The government settled the case against the company for $704 million. The reward in this case,

however, was far above the norm. In 2010, the Justice Department recovered a total of $53.7 billion under the False Claims Act, up from $53.5 billion collected in 2009.11 Although some of these cases might not have been pursued had it not been for the False Claims Act, many people are opposed to the act. Some argue that the whistleblowers are receiving money that should belong to the taxpayers; others say that the act prompts people to refrain from reporting fraud right away but wait until the value of the case grows. Still others complain that the act results in frivolous lawsuits as employees try to find an easy way to make money. Defenders of the False Claims Act point out that the act has led to revelation of some significant cases of fraud that otherwise might have cost the government millions of dollars. They also point out that when an employee does report a fraudulent employer, it becomes very difficult for that employee to get a job in the same field in the future; thus, a significant incentive needs to be offered to convince employees to report such fraud. Page 135 A number of False Claims Act cases have been filed against universities, including an interesting case filed in 2006 against Chapman University. In this case, three faculty members alleged that the institution for years encouraged early dismissals, resulting in many students not getting the minimum classroom training required in several subjects. If the college had admitted that it had engaged in this practice, it would never have been accredited and thus never have received millions of dollars in federal grants and student aid, which the lawsuit claimed it took under false pretenses.12 The case was ultimately dismissed by a Summary Judgment in 2007, and in 2011, the plaintiff's appeal to the U.S. Supreme Court was denied. Other False Claims Act cases against universities have been more successful. For example, in 2009, the University of Phoenix settled a False Claims Act suit for $67.5 million for violating federal law that prohibits colleges from paying admissions counselors incentives based on the number of students recruited. The Sarbanes-Oxley Act Unlike RICO and the False Claims Act, the Sarbanes-Oxley (SOX) Act of 2002 was intended to curb white-collar crime. Congress passed Sarbanes-Oxley largely in response to the business scandals of the early 2000s, such as Enron, WorldCom, and Global Crossing, as well as the accounting firm Arthur Andersen. Although much of the act consists of new rules and regulations for accounting firms, part of the act specifically addresses the issue of white-collar crime. Global Context Digital Archive Japan/Alamy Stock Photo Tools for Fighting White-Collar Crime in the UK The UK has a couple tools that it uses to fight white-collar crime. The first is national whistleblower statute, the Public Interest Disclosure Act of 1998 (PIDA), which protects the whistleblower from firing or retaliation if he or she makes a good-faith disclosure based on genuine concerns about crime, civil offenses, miscarriage of justice, danger to health and safety or the environment, and the cover-up of any of these. The emphasis of PIDA is on fixing the problem within the company. The most protected, and preferred, disclosure is one that is made to a manager within the company, so the first step is often to disclose the

possible violation to a manager in the company. Sometimes such disclosures are not always advisable or possible, so disclosures to the appropriate ministry are protected, when applicable, as well as disclosures to the appropriate regulatory agency, such as the Health and Safety Executive. Rather than just having a suspicion of wrongdoing, whistleblowers must believe that their allegations are substantially true before disclosing them to a regulator. If the whistleblower reasonably believed that he or she would be victimized for disclosure to the company or regulator, reasonably believed that a cover-up was likely and there was no prescribed regulator, or had already raised the issue internally or with a regulator and no action had been taken, he or she would be protected for a wider disclosure. The whistleblowers do not get monetary rewards, as do whistleblowers in the United States under the False Claims Act. Instead, they may be protected and compensated if action is taken against them. The second tool used in the UK is the unexplained wealth order, a new power that enforcement authorities were given in 2018 to help them fight suspected corruption. The order requires "a person who is reasonably suspected of involvement in, or of being connected to a person involved in, serious crime" to explain how he obtained his property if his lawful income appears to be insufficient to afford it or face seizure of the property. The first two unexplained wealth orders were issued in 2018 against a woman whose husband, the former chairman of the state-controlled International Bank of Azerbaijan, is serving15 years on fraud and embezzlement charges. She was placed under a court order to explain how she obtained the money to purchase two properties worth £22 million ($29 million) in total or forfeit the properties. She appealed that order multiple times, and in December 2020, she lost her final appeal. The second order was issued over jewelry worth 4 million pounds that was seized from Christie's Auction House, where she had consigned the jewelry. As of press time, further hearings regarding the jewelry seizures were still scheduled to take place. Sarbanes-Oxley makes it illegal for registered public accounting firms to provide nonaudit services to an audit client. Section 201 of the act specifically names as illegal: Bookkeeping or other services related to the accounting records or financial statements of the audit client. Financial information systems design and implementation. Appraisal or valuation services, fairness opinions, or contribution-in-kind reports. Actuarial services. Internal audit outsourcing services. Management functions or human resources. Broker or dealer, investment adviser, or investment banking services. Legal services and expert services unrelated to the audit. Any other service that the board determines, by regulation, is impermissible. In addition to criminalizing these activities, Sarbanes-Oxley has amended the penalties associated with other white-collar crimes. Under Sarbanes-Oxley, it is now a felony to fail willfully to maintain proper records of audits and work papers for at least five years, and the punishment for not maintaining these records is up to 10 years' imprisonment. Also, the destruction of documents received updated punishments. The

destruction of documents involved in a federal bankruptcy investigation is now a felony, with possible sentences of up to 20 years' imprisonment. Similarly, the punishment for securities fraud has been increased to 25 years' imprisonment. In addition, Sarbanes-Oxley has extended the statute of limitations regarding the discovery of fraud. The statute of limitations now extends to two years from the date of discovery of the fraud and five years from the criminal act. The old statute was one year from discovery and three from the act. Also, much like the False Claims Act, Sarbanes-Oxley has taken affirmative steps toward further protecting whistleblowers. State Whistleblower Protection Laws Forty-seven states currently have whistleblower protection laws for either public or private sector employees or both. However, these laws are very different, so it is important for both employers and employees to know the law in their state. The biggest difference among the states is to whom the violation may or must be reported. In many states, employees in the private sector receive protection from retaliation only if they report the wrongdoing to an external governmental body. Other states take the opposite approach and require the whistleblower to report his suspicions first internally to his supervisors. Almost no states protect employees who choose to go to the media with their reports of employer wrongdoing. Page 136 CASE Nugget Does Whistle-blower Protection under Sarbanes-Oxley Extend to Employees of Private Contractors Serving Public Companies? Lawson v. FMR LLC 134 S. Ct. 1158 (2012) Plaintiffs were former employees of FMR, a group of private companies that contracted to advise or manage mutual funds. As is common in the industry, the mutual funds FMR served are public companies with no employees. Both plaintiffs allege that they blew the whistle on putative fraud relating to the mutual funds and, as a consequence, suffered retaliation by FMR. Each filed suit in federal court. Moving to dismiss the suits, FMR argued that the plaintiffs could state no claim under Sarbanes-Oxley's whistlerblower protection provision because that provision protects only employees of public companies, not employees of private companies that contract with public companies. On appeal from the District Court's denial of FMR's motion to dismiss, the First Circuit reversed, concluding that the term "an employee" under SOX refers only to employees of public companies. The U.S. Supreme Court, however, reversed that decision, giving a broader interpretation of the statute and finding that the act's whistleblower protection includes employees of a public company's private contractors and subcontractors. As the court pointed out, to hold otherwise would be to allow the entire mutual fund industry to insulate itself because virtually all mutual funds are structured so that they have no employees of their own; they are managed, instead, by independent investment advisors. The high court also pointed out that this construction was analogous to the whistle-blower protection given to employees in the aviation industry, in which the term employees includes protection of employees of contractors and subcontractors of air carriers. CASE OPENER WRAP-UP A Questionable Stock Investment The defendant was

convicted of one count of securities fraud for his misrepresentations related to stock he sold the hotel investor. He was also convicted one count of mail fraud for sending the stock certificates via Federal Express, and one count of wire fraud for causing the approximately $1,486,323 from the hotel investor to be diverted to his own use through an interstate wire transfer of said funds to a Citibank account the defendant maintained in New York, New York. On appeal, the conviction was upheld in 2014. Had this been an older case, the fact that the certificates were sent via Federal Express would have been important, but the mail fraud statute has now been amended to specifically include the use of commercial postal services including Federal Express and UPS. Page 137 PRACTICAL TIPS for Business Managers White-collar crime can cripple your business or, at the very least, greatly damage its reputation. Thus, as a business manager, you will want to root out white-collar crime before it becomes a problem. Maintaining an internal audit service with effective and trained auditors can help you keep white-collar crime to a minimum. Provide your employees with proper training so that they understand what is and is not considered ethical and legal activity within your business. Screen potential employees properly and thoroughly to ensure that they have a clean record before appointing them to senior positions.

SUMMARY The Nature and Elements of a Crime The elements of a crime are Actus reus: Wrongful behavior (guilty act). Mens rea: Wrongful state of mind or intent (guilty mind). Crimes are classified into three categories: Felonies: Serious crimes punishable by imprisonment for more than one year or by death. Misdemeanors: Less serious crimes punishable by fines or imprisonment for less than one year. Petty offenses: Minor misdemeanors punishable by small fines or short jail sentences. White-Collar Crime White-collar crimes include Bribery, Extortion, Fraud, Embezzlement and Computer crimes (destruction of computer data, unlawful appropriation of data or services). Corporate Criminal Liability Both corporations, as legal entities, and the corporate officers and managers can be held liable for crimes committed on behalf of the corporation. Criminal Procedure Pretrial procedure: The arrest, booking, first appearance, indictment, and arraignment. Trial procedure: Jury selection, trial with burden of proof on prosecution, jury deliberations, jury verdict, and (if guilty) sentencing hearing. Posttrial procedure: Appeal. Tools for Fighting Business Crime RICO: Prohibits persons employed by or associated with an enterprise from engaging in a pattern of racketeering activity. Anyone whose business or property has been damaged by this pattern of activity can sue under RICO to recover treble damages and attorney fees in a civil action. False Claims Act: Allows employees to sue employers on behalf of the federal government for fraud against the government. The employee retains a share of the recovery as a reward for his or her efforts. Sarbanes-Oxley

Act: Criminalizes specific nonaudit services when provided by a registered accounting firm to an audit client; also increases the punishment for a number of white-collar offenses.

Point/Counterpoint As you are considering this issue, you might want to think about statistics that would help you resolve it. Should Insider Trading be Made Legal? YES NO The ban on insider trading is intended to level the playing field for all investors and make the securities market more fair. However, not only does the reality of banning insider trading fail to live up to its intentions, there are several ways that legalized insider trading could actually help the securities market as a whole. For example, as the law stands now, insiders who know that a stock is going to tank in the future can only sit by and do nothing as the price of the stock remains the same and unwitting investors continue to buy in. Take Enron, for example. Enron had been cooking its books for some time before its collapse, and because this practice had remained a secret, the price of Enron's stock remained largely unaffected. The insiders who knew about Enron's shady actions were effectively barred from selling their soon-to-be-worthless stock. If they had been able to sell their stock well before Enron's collapse, surely the market would take notice of the mass selling, and the stock would be much less attractive to investors. Instead of more investors unwittingly buying worthless stock prior to a crash, the price could have gradually decreased to its accurate value due to insider sell-offs, and future investors could have been warned, which would have prevented the whole Enron crisis in the first place. Moreover, white-collar crime tends to affect higher-income individuals, whereas street crime tends to affect lower-income individuals who lack the resources to protect themselves. Street crime disproportionately affects lower-income individuals who cannot afford the private security measures that higher-income individuals use to protect their persons and their property. The law ought to protect those who lack the power to protect themselves. A second reason is that other markets use insider trading and function just fine. The real-estate market is a good example of a market where insider trading is common. For example, say someone is selling a house, and you have insider information that something about the house or the property makes it more valuable than the price that the seller is offering. You pay the seller's price and obtain the house. Both parties walk away happy: the seller sold the house for the price they wanted, and you got the house for a lower price than you thought you would have to pay. A final reason is that it is incredibly hard to make insider trading charges stick. Being that we cannot read the mind of a defendant in an insider trading case, it is almost impossible to know what someone knew and when they knew it. Investigating and prosecuting insider trading is inefficient and highly

resource-consuming. During the 2009 investigation of the Galleon Group, the federal government pored over 14,000 wiretapped phone conversations looking for evidence of insider trading. Often, even the most high-profile insider trading cases end up with next to nothing: after all the noise made in Martha Stewart's insider trading case, she was convicted of obstruction of justice and lying to investigators, not insider trading. The government would be much better off using their resources to detect and prevent large-scale crises such as the Enron crash than going after something as victimless as insider trading. Insider trading can do great harm to investors as well as to the securities market as a whole, and the practice has been made illegal for good reasons. First, insider trading almost necessarily leads to investors with insider information cheating other investors without insider information. If an insider knows that a stock's value is about to skyrocket, he can buy multiple shares for much less than what they are worth and give another investor a bad deal. If an insider knows that a stock's value is about to plummet, he can sell off all of his shares to unwitting investors who are now about to lose a lot of money on their investment. In either case, the insider unfairly profits. The above explanation leads directly into another reason insider trading is illegal: if investors were constantly worried about getting cheated by insider trading, the integrity of the securities market would be damaged, and many investors would be discouraged from participating in the market. Fewer investors means fewer buyers and sellers and, therefore, less money being invested into businesses. A final reason, which is closely tied to the previous reason, is that legalizing insider trading would endanger market transparency and corporate transparency. If an insider comes across nonpublic information, he is likely to hide this information not only from the public but from the corporate directors as well in order to maximize his profits. If the corporate directors are unaware of this information, they cannot provide accurate financial information to the public and the public cannot make well-informed investments. The market simply cannot properly operate if it lacks transparency and is full of trades made on secret information. In insider trading cases, the only people who truly win are the insiders.

Questions & Problems Name and explain the two elements of a crime. Identify the distinguishing features of white-collar crime. List and define the primary affirmative defenses used in criminal cases. List and describe the main types of fraud committed in the business context. What is meant by reading a defendant his Miranda rights, and why are these rights important? Explain the steps of a criminal prosecution. Explain the federal laws that are currently being used to fight white-collar crime. Jack DeCoster owned Quality Egg, LLC, an Iowa egg production company. Jack's son Peter DeCoster served as the company's chief operating officer. Jack also owned and operated several egg production companies in Maine, and Peter worked at those facilities. In 2008, salmonella enteritidis

("salmonella") tests conducted at the Maine facilities came back positive. Other than conducting the single egg test in April 2009, Quality Egg did not test or divert eggs from the market before July 2010 despite receiving multiple positive environmental and hen test results. The Centers for Disease Control and Prevention estimated that about 56,000 Americans fell ill with salmonellosis in 2010 after consuming contaminated eggs. In August 2010, federal and state officials determined that the salmonella outbreak had originated at Quality Egg's facilities. A criminal investigation was opened, and Jack and Peter pled guilty as responsible corporate officers for introducing adulterated eggs into interstate commerce. The DeCosters now appeal their prison sentences, arguing that they had not known the eggs were contaminated at the time they were shipped. Do you believe the DeCosters were successful in their appeal? Why or why not? Source: US v. DeCoster, 828 F.3d 626 (8th Cir. 2016I Just a typo. Should read 2016). Robert Carr is the founder of Heartland Payment Systems, Inc. Carr was heavily involved in negotiations with Global Payments, Inc. concerning the acquisition of Heartland by Global. During this time, Carr's girlfriend, Katherine Hanratty, frequently expressed her concern regarding her financial security. Carr reassured her by discussing the progress of the negotiations. Later, Carr gave Hanratty a check for $1 million and told her to invest $900,000 in Heartland shares. Hanratty complied and purchased 11,000 shares of Heartland stock. Soon after, Heartland and Global announced their acquisition deal, causing the value of Heartland's stock to soar. Hanratty then consulted with Carr about when to sell the stock. Following this conversation, Hanratty sold all her Heartland stock at once, netting her $250,000 in profits. Eventually, the SEC discovered Hanratty's activity. What do you think the SEC's charges were? Who do you think was held responsible: Carr, Hanratty, or both? Why? Source: SEC v. Robert O. Carr and Katherine M, Hanratty, No. 3:18-cv-01135 (D. Connecticut) (2018). Page 140 After the financial crisis of 2008, Anchor BanCorp Wisconsin (ABCW), and its subsidiaries AnchorBank and Investment Directions, Inc. (IDI) were in dire straits. AnchorBank and ABCW were trying to negotiate an extension for a $116 million loan from U.S. Bank with a large payment due by the end of March 2009. On December 29, 2008, David Weimert, the vice president of AnchorBank and the president of IDI, was instructed to sell commercial properties held by IDI to acquire the cash to pay U.S. Bank in March. Weimart successfully closed a deal that resulted in $2 million more than he was told to sell for while also reducing IDI's mortgage liability by $15 million, therefore freeing more money that could be sent to AnchorBank or ABCW. In closing the deal, however, Weimert saw an opportunity to insert himself into the transaction. Weimert convinced the two prospective buyers that he would be a useful partner. Both buyers included a provision having Weimert buy a small percentage of the property in their offer letter. Testimony given at the subsequent trial revealed that Weimert had misled the board of directors that the buyers would not purchase the property unless he was included in the deal. Indeed, Weimert was

convicted of five out of six counts of wire fraud on the theory that his actions were part of a scheme to obtain money or property by fraud. Weimert appealed the ruling on grounds that his actions did not rise to the level of fraud. Source: United States v. Weimert, 819 F. 3d 351 (2016). From 2004 to 2010, Edward Weaver was the CEO of Vendstar, a corporation that sold candy-vending machines to approximately 7,000 customers who spent a total of about $62 million on the investments. Although Vendstar's promotional materials and salespeople represented that the investment opportunities would be lucrative, for the most part, the vending machines would earn Vendstar's customers almost no money. Customer complaints became so frequent that Weaver assigned a Vendstar employee to respond to those complaints full time. In the end, many customers lost virtually all of their investments in Vendstar. The size of the investments varied, and the most common transaction involved the victim paying $10,000 for a package that included 30 candy-vending machines and an initial supply of candy, although some customers spent significantly more than that. Under the Vendstar scheme, potential customers would respond to Internet or newspaper ads approved by Weaver. Vendstar would mail them a brochure, order form, and certain disclosure documents. The brochure, which Weaver also approved, included claims that the salespeople were "Vendstar vendors themselves" and promised that the investments had "little risk." Vendstar salespeople would then follow up with customers over the phone. During those phone conversations, salespeople routinely lied to customers, promising them utterly unrealistic earnings and claiming that the investments were sound. Salespeople also falsely stated that they owned their own Vendstar machines, a misrepresentation that encouraged customers to trust them and buy the machines. At trial, victims of the scam testified that those lies influenced their decision to purchase the machines. If customers agreed to purchase the machines, they signed a contract that included the following disclaimers in capital letters: Purchaser understands that seller has no affiliation or financial relationship with professional locating companies and that seller has no involvement whatsoever in securing retail locations. . . . Purchaser and seller agree that this purchase order contains the entire understanding of the agreement between the parties and there is no reliance upon any verbal representation whatsoever. Seller has not guaranteed any minimum or maximum earnings. . . . It is further acknowledged that no statements, promises[,] or agreements influenced this purchase or are expected other than anything contained in this purchase order. . . . What crime do you think Weaver was convicted of? Weaver appealed this conviction. What do you think his argument on appeal was? Do you think his conviction was upheld? Source: United States v. Weaver, 860 F.3d 90; 2017 U.S. App. LEXIS 10948. Robert Shapiro was the owner and CEO of Woodbridge, a supposed investment firm. Woodbridge's main business model was to solicit money from individuals to invest in "low risk" and "conservative" investments. According to Woodbridge, these investments were tied to real estate owned by third parties

and that these third parties would be making interest payments to Woodbridge and the investors. In reality, Shapiro owned all of the investment properties and was perpetrating a Ponzi scheme, using new investors' money to pay off old investors. Shapiro created and controlled a network of more than 270 LLCs to buy and sell the properties to trick investors and cover his tracks. In total, Shapiro and his associates gathered over $1.29 billion in investments from over 9,000 individuals. However, Shapiro was unable to keep up with his own massive scam, and his misdeeds were discovered when Woodbridge filed for bankruptcy. What crime do you think Shapiro would have been convicted of? Why? Source: In re Woodbridge Group of Companies, LLC, 592 BR 761 (2018). Toby Scammel's girlfriend was briefly involved in Disney's acquisition of Marvel in 2009. Scammel bought 659 Marvel options for $5,465 in the days prior to the announcement of the acquisition. Within the nine days following the announcement, Scammel sold all his Marvel shares, amounting to a total of $192,496.61. Although Scammel's girlfriend would mention general facts about a big project she was working on, the couple claimed that she never gave him details about the acquisition. However, he had access to her electronic documents related to the acquisition and had begun piecing together the companies involved and the timing of the acquisition. Scammel's girlfriend had confidential information about the deal, including that Disney would pay $50 per share for Marvel and that the deal would be announced by Labor Day. Scammel claimed that his girlfriend had told him nothing and that he had done nothing wrong; he had frequently been involved in the stock market and was simply trading shares normally as he had done before. The SEC, in its investigation, also learned just before he purchased many of the Marvel securities, Scammel searched the internet for the terms "insider trading," "material, non-public information," and "Rule 10b-5." What crime do you believe Scammel was charged with? Do you think there was enough evidence to warrant his conviction for that crime? Source: SEC v. Scammel, 2011 WL 3506153 (C.A.C.D. Aug. 11, 2011). On November 11, 2011, the window of Jamie Williams's house was allegedly broken by someone who then entered through the broken window and removed several items, including a laptop computer. One day after the incident, Williams filed a report, naming Sammie Smith as the perpetrator. At the trial, Williams testified that he saw Smith running away from his house on the night of the burglary. Williams's neighbor, Dacorious Clark, also testified, stating that on November 11, Smith showed up at his house with a laptop computer tucked into his pants. Smith allegedly tried to sell the computer to Clark. Clark declined the offer but was asked to keep the device anyway. After opening the computer and looking at the login screen, Clark realized that the laptop belonged to Williams, and returned it to him one week after the night of the incident. Smith was the only witness for the defense and testified that he was at a football game on the night of the burglary. According to Smith, he met his cousin and exchanged a bag of marijuana for the computer and then traded the computer with Clark for $60 worth of cocaine. Based on the

testimony presented at the trial, what crime do you believe Smith was convicted of? On appeal, do you believe the appellate court found that there was sufficient evidence to convict Smith? Source: Sammie Smith v. State of Mississippi, 150 So. 3d 122 (2014).